

**The Internal Revenue Service
Needs to Improve Oversight of
Remittance Processing Operations**

October 2002

Reference Number: 2003-40-002

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

October 7, 2002

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in cursive script, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Acting Inspector General

SUBJECT: Final Audit Report - The Internal Revenue Service Needs to
Improve Oversight of Remittance Processing Operations
(Audit # 200240026)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) has established adequate controls to ensure that payments are accurately posted to taxpayers' accounts.

Each year the IRS Submission Processing Campuses (SPC) receive millions of remittances totaling billions of dollars. In Fiscal Year (FY) 2001 alone, the IRS processed more than 40 million remittances totaling over \$171 billion. The IRS has several initiatives to improve the accuracy of processing payments to Wage and Investment (W&I) taxpayers' accounts, including a local quality review program and a new national performance measurement process called the Deposit Error Measure. These reviews are based on evaluations of statistically valid samples of remittances randomly selected from work in process. However, the IRS needs to improve oversight at both the national and local levels to ensure that review programs are conducted consistently and correctly to maintain the statistical validity of the review results and that cases are properly reviewed to ensure the accuracy of feedback to management. The actual error rates on the reports that we reviewed should have been much higher than the deposit error rates that were reported.

In summary, our review showed that the Deposit Error Measure has a statistically valid sampling plan; however, the plan is not being consistently implemented by the SPCs. Although we visited only two campuses, there were significant differences in both the determination of the number of cases to select for review and the methods of selecting the cases.

We believe that a combination of factors contributed to the problems. First, this is a new measure and each location is still experimenting to identify the best way to implement the program. Second, at the time of our review, there had been limited national visitations to ensure that the program has been implemented consistently and correctly. As a result, review results may not be statistically valid and management may not be able to make proper decisions to improve the remittance processing operation.

We also determined that Deposit Error reviewers did not identify all deposit errors. Based on our re-evaluation of the same sample cases used to prepare the April 2002 report for the Austin and Fresno SPCs, the actual error rates for April were 37.5 and 31.8 percent higher than the error rates that were reported, respectively. The error rate in Austin increased from 4.8 percent to 6.6 percent, and the error rate in Fresno increased from 10.7 percent to 14.1 percent. The deposit error rate goals for FY 2002 were 2.6 percent for Austin and 3.4 percent for Fresno.

We attribute the problem to a lack of effective managerial oversight. In Austin, the manager did not review all the sample cases, only the error cases. Although this would ensure that identified errors were properly reported, it would not identify undetected errors on cases considered error-free. In Fresno, the manager did not perform any reviews of the analyst's work. As a result, management did not receive accurate feedback on the quality of remittance processing and was limited in identifying sources of errors, analyzing error trends, and recommending corrective actions.

Management's Response: IRS management agreed with our recommendations and has already completed corrective action. Specifically, the Director, Submission Processing (SP), sent an e-mail to all SP Directors asking them to ensure the appropriate sampling techniques are followed and to review monthly a sample of all measured cases. Conferences were held with the sites and visits to campuses began June 17, 2002. In addition, Program Analysis System (PAS) managers were reminded during the Balanced Measures conference that they must adhere to the procedures in the Balanced Measure Internal Revenue Manual 3.0.275.1.3.2(2). These procedures require them to review monthly a sample of all work assigned to PAS analysts. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

**The Internal Revenue Service Needs to Improve
Oversight of Remittance Processing Operations**

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The Internal Revenue Service Needs to Improve Oversight of Remittance Processing Operations

Background

Each year the Internal Revenue Service (IRS) Submission Processing Campuses (SPC) receive millions of remittances totaling billions of dollars. Some of these remittances are sent directly to the campuses by taxpayers, some are forwarded from Lockbox banks,¹ and some are forwarded from IRS field office personnel to the campuses for processing. In Fiscal Year (FY) 2001 alone, the IRS processed more than 40 million remittances totaling over \$171 billion.

When remittances arrive at the SPCs, they are reviewed to determine whether enough information is available for the payment to be processed and posted to the correct taxpayer's account. Perfect documents² are sent directly to the Residual Remittance Processing System (RRPS),³ while those requiring additional research (imperfect documents) are sent to the Payment Perfection Unit. Once the research has been completed and the remittance is considered perfect, it is sent to the RRPS for processing.

In the RRPS, information from the source document and the remittance are input to the computer system. The remittances are then scanned into another system that provides validity checks for the dollar amounts previously entered. After these validity checks, the remittances are sent to the Federal Reserve Bank for deposit.

During FY 2001, the IRS implemented a national Deposit Error Measure designed to assess the accuracy of posting remittances to taxpayer accounts. This measurement is based on a statistically valid sampling plan. The sample is randomly selected from all types of remittances coming into the SPCs, regardless of deposit method. Each day cases

¹ Taxpayers mail remittances and vouchers to a designated Post Office Box at a commercial bank where the remittances are processed and deposited.

² A perfect document is described as a source document that contains a legible taxpayer name, a taxpayer identification number, one tax type, one tax period, and one remittance.

³ The RRPS is a multi-functional remittance processing system for processing payments and controlling related source documents. It computerizes the recap of each day's deposit information, simultaneously preparing tapes to post credits to taxpayers' accounts.

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such as perfected remittances, imperfect remittances, field offices remittances, large dollar cases,⁴ and Lockbox payments are randomly selected. Case file information is copied and retained, and the case is returned to the work stream. After approximately 2 weeks, Program Analysis System (PAS) analysts review cases to determine if the IRS correctly followed the initial taxpayer intent in processing the deposit and, if clear taxpayer intent was not present, if the IRS followed correct procedures. The errors found during the analysis are compiled and used to compute the Deposit Error Rate (cases with errors/total cases reviewed). The overall Deposit Error Rate is a cumulative figure computed at the end of the fiscal year.

Wage and Investment (W&I) Headquarters set a cumulative target Deposit Error Rate of 3.4 percent for SPCs for FY 2002. This goal was based upon the average of the May 2001 cumulative rates, excluding the highest and lowest individual campus rates. As of May 2002, the cumulative W&I measure was 3.8 percent. Goals were also set for the individual SPCs. These goals were based on the FY 2002 corporate goal and the campus' May 2001 cumulative rate. If the campus' May 2001 cumulative rate met or exceeded the FY 2002 corporate goal, the campus' goal was set at its May 2001 cumulative rate. If the campus' May 2001 cumulative rate did not meet or exceed the FY 2002 corporate goal, then the campus' goal was set at the FY 2002 corporate goal.

The IRS expects to achieve its targets based upon the monitoring and reviewing of deposit errors, resulting in systemic and procedural change requests. The results of these structured statistical reviews are captured in national databases and reports are updated monthly. The local review staffs provide feedback to the processing areas and to National Headquarters analysts.

Our overall objective was to determine whether the IRS has established adequate controls to ensure that payments are

⁴ A remittance is considered large dollar if it is over \$5,000 and under \$1 million in the SPC and over \$50,000 and under \$1 million at a Lockbox bank. Remittances over \$1 million require additional controls.

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The Internal Revenue Service Has Initiatives to Improve the Accuracy of Processing Payments

accurately posted to taxpayers' accounts. We conducted this review from May to July 2002 at the Austin and Fresno SPCs and in New Carrollton, Maryland. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The IRS has several initiatives to improve the accuracy of processing payments to W&I taxpayers' accounts. It established both a local quality review program and a new national performance measurement process called the Deposit Error Measure. The new Deposit Error Measure provides an estimate of the accuracy of payments posting to taxpayers' accounts on both national and individual SPC levels. The results of the program can be used by managers to improve operations at individual sites and to help set performance goals to improve the overall deposit program.

The success of the Deposit Error Measure depends in large part on the IRS' ability to establish meaningful standards, to measure the success of the program, and to correct errors and improve deposit activity. To its credit, the IRS used historical data to establish national and local goals for the Deposit Error Rates. It also recognizes that the Deposit Error Measure is new and program results need to be monitored to make meaningful and necessary adjustments to goals for subsequent years.

The IRS also provides a certain amount of national oversight over the measure to assess its success. The oversight actions include holding periodic conference calls with nationwide PAS analysts to discuss deposit measure issues, monitoring the monthly samples being collected, and reviewing how error cases are coded. In addition, the National Headquarters Deposit Error Balanced Measure staff has recently begun making visitations to the SPCs.

The IRS developed a statistically valid sampling plan to randomly select actual remittances for review. To ensure consistent application of the sampling plan and comparable review results, the IRS developed written instructions called the Deposit Accuracy User Guide. With the help of this User Guide and the sampling plan, reviewers – whose duties

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are independent from the functions being reviewed – select and analyze the remittances to determine whether payments are accurately posted to taxpayers’ accounts.

Moreover, to effectively collect accurate data, the IRS created a national computerized database called the Submission Processing Measures Analysis and Reporting Tool (SMART). The data collected by the reviewers is annotated on a case review form and then entered into the SMART. Reports are then generated that provide accuracy rates and other quality-related information.

The IRS uses the review results to improve the Deposit Error Measure. At the national level, management uses the review results to assess the overall quality of payment processing. At the local level, management uses the findings to correct errors and develop local improvement actions. The reviewers generally pull their sample and complete their analyses in time to promptly correct any errors on individual cases included in the review. However, the IRS needs to improve oversight at both the national and local levels to ensure that the review programs are conducted consistently and correctly.

The Deposit Error Measure Sampling Plan Is Not Consistently Implemented

The Statistics of Income Division must accurately determine the sample size and skip interval for the Deposit Error Measure to be statistically valid. While there is some flexibility from campus to campus, the sample must be reflective of the entire universe of remittances processed. To ensure this, PAS clerks are required to follow a systematic sampling technique based on the pre-determined skip intervals and sample size. The sample selection guidelines provide that clerks manually count all available remittances and select every “nth” document. PAS reviewers are mandated to input all cases selected for the sample in a database system and examine each case thoroughly.

Our review showed that the Deposit Error Measure has a statistically valid sampling plan; however, the plan is not being consistently implemented by the SPCs. Although we visited only two campuses, there were significant differences in both the determination of the number of cases to select for review and the methods of selecting the cases.

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Our evaluation of the samples that had been taken and our observation of cases being sampled identified the following problems:

- The analyst at the Fresno SPC incorrectly used an old sample plan and selected 261 cases for review instead of the required 168 cases. Also, to get the necessary remittances to achieve the above sample size, the analyst had a clerk select the additional remittances judgmentally instead of using the stated skip interval.
- At the Austin SPC, a clerk made hourly trips to count the remittances that had been received and selected a remittance for the sample whenever the skip interval was reached. This required a count of all remittances received and resulted in a very labor-intensive process that was an inefficient use of the clerk's time.
- A new sampling technique being tested at the Fresno SPC may be more efficient but may not allow each remittance an equal chance of being selected. The clerk uses daily incoming volume tabulations and the predetermined skip interval to determine the number of remittances to be pulled. However, the clerk judgmentally selected the remittances from those available rather than selecting every "nth" remittance as prescribed by the skip interval.

We believe that a combination of factors contributed to the problems. First, this is a new measure and each location is still experimenting to identify the best way to implement the program. Second, at the time of our review, there had been limited national visitations to ensure that the program has been implemented consistently and correctly. As a result of the inconsistent implementation of and deviations from the sampling plan, the review results may not be statistically valid and management may not be able to make proper decisions to improve the remittance processing operation.

Recommendation

1. The Director, W&I Division, Customer Account Services, should ensure that the sampling plan is being implemented consistently at the SPCs. Field visitations

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and increased oversight by the National Headquarters Deposit Error Balanced Measure staff could provide additional guidance and direction to the individual campuses.

Management's Response: The IRS stated, "The Director, Submission Processing (SP) sent an e-mail to all SP Directors asking them to ensure the appropriate sampling techniques are followed and to review monthly a sample of all measured cases. Conferences have been held with the sites and visits to campuses began June 17, 2002."

All Payment Processing Errors Are Not Being Identified

The Deposit Error Measure is one of the IRS' balanced measures and is used to show the percentage of misapplied payments at SPCs. PAS Deposit Error reviewers are required to thoroughly examine a copy of the remittances and associated posting documents that were sampled. The results are compared with established procedures to assess the accuracy of case processing.

Unfortunately, the reviewers did not identify all deposit errors. In Austin, the actual error rate was 37.5 percent higher than the rate reported; and in Fresno, the actual rate was 31.8 percent higher than the rate reported. Our results are based on re-evaluating the same cases that PAS analysts reviewed to prepare the April 2002 report and include the following errors:

- The Austin SPC PAS staff identified 8 remittances out of their sample of 166 that contained deposit-related errors (4.8 percent error rate). We identified 3 additional cases with errors that increased the error rate to 6.6 percent.
- The Fresno SPC PAS staff identified 28 remittances out of their sample of 262 that contained deposit-related errors (10.7 percent error rate). We identified 9 additional cases with errors that increased the error rate to 14.1 percent.

Our analysis of the error cases did not identify any new trends. The errors consisted primarily of incorrect transaction dates, incorrect transaction codes, incorrect tax periods, and incorrect payee information. We did not

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identify any cases in which the remittance was posted to the incorrect taxpayer's account.

We attribute the problem to a lack of effective managerial oversight. PAS managers are charged with maintaining the integrity and quality of the program by monitoring and reviewing the work of the PAS analysts assigned to them. However, this is not always taking place. In Austin, the manager did not review all the sample cases, only the error cases. Although this would ensure that identified errors were properly reported, it would not identify undetected errors on cases considered error-free. In Fresno, the manager did not perform any reviews of the analyst's work. Closer managerial involvement could help identify any omissions or oversights on the part of the analysts.

The error rates that we recomputed for April at both locations exceeded the FY 2002 goals (Austin 2.6 percent and Fresno 3.4 percent). As a result, the Deposit Error Rates for both Austin and Fresno were significantly understated and there were more remittance processing errors than previously reported. Unless feedback on the quality of remittance processing is accurate, management will be limited in identifying sources of errors, analyzing error trends, and recommending corrective actions.

Recommendation

2. PAS first-line managers should provide increased oversight to ensure that all processing errors are identified during the Deposit Error Measure sample review. Specifically, PAS managers at SPCs should include all cases in their reviews to ensure that all errors are identified and reported.

Management's Response: The IRS stated, "We told PAS managers during the Balanced Measures conference that they must adhere to the procedures in the Balanced Measure Internal Revenue Manual 3.0.275.1.3.2(2). These procedures require them to review monthly a sample of all work assigned to PAS analysts."

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) has established adequate controls to ensure that payments are accurately posted to taxpayers' accounts. We performed the following tests to accomplish this objective:

- I. Determined whether the IRS had established standards for accuracy of applying payments. We identified the corporate Deposit Error Rate goals for the National level, Wage and Investment (W&I) Division, and W&I Submission Processing Campuses (SPC) and determined how the goals were set.
- II. Determined whether the IRS had established an effective system to measure the accuracy of applying payments and whether the system is properly and consistently applied at the various sites.
 - A. Determined how the IRS' Deposit Error sampling plan was developed and whether the plan is valid.
 - B. Evaluated the IRS' implementation of the sampling plan and whether the Program Analysis System (PAS) Deposit Error review process is effective and consistently applied.
 - C. Selected and analyzed a sample of cases that had been selected for the PAS review function and determined whether we agreed with the results.
- III. Evaluated how the IRS identified problems and analyzed the cause for inaccurate and untimely payment applications.
 - A. Identified and obtained reports on Deposit Error Rates and evaluated the effectiveness of the data and analyses contained in the reports.
 - B. Determined how errors identified during the PAS review were corrected, selected a sample of identified errors, and verified whether the corrections had been made.
- IV. Evaluated the corrective actions taken by the IRS to improve the application of remittances to taxpayers' accounts.
 - A. Interviewed National Headquarters and local management officials to determine what steps were taken to address and improve deposit accuracy.
 - B. Evaluated corrective actions by management based on the results of the PAS review.

Major Contributors to This Report

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)

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**The Internal Revenue Service Needs to Improve
Oversight of Remittance Processing Operations**

Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner N:DC
Deputy Commissioner, Wage and Investment Division W
Director, Customer Account Services, Wage and Investment Division W:CAS
Director, Submission Processing, Wage and Investment Division W:CAS:SP
Director, Strategy and Finance W:S
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:F:M
Audit Liaisons:
 Director, Submission Processing, Wage and Investment Division W:CAS:SP
 Program/Process Assistant Coordinator, Wage and Investment Division W:HR

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Appendix IV

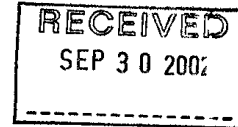
Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

September 30, 2002



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM:

John M. Dalrymple
John M. Dalrymple
Commissioner, Wage and Investment Division

SUBJECT:

Draft Audit Report – "The Internal Revenue Service Needs to Improve Oversight of Remittance Processing Operations"
(Audit # 200240026)

I reviewed your report and concur with your recommendations. I am pleased that it reflects the effectiveness of the IRS in processing, posting, and accounting for over 40 million remittances to Wage and Investment taxpayers' accounts, resulting in the timely deposit of over \$171 billion to the U.S. Treasury.

The IRS views its remittance processing responsibility as critical to the overall effectiveness of our agency. As a result, in FY 2001 we implemented several initiatives designed to assure the accuracy and timeliness of these deposit operations, including implementing the new Deposit Error Balanced Measure. This new measure, first operational in February 2001, is based on a statistically valid sampling plan developed by the Statistics of Income Division. It provides an estimate of the accuracy of payment postings on a submission processing center (SPC) and national level, thereby allowing us to identify opportunities for improvements at individual locations, as well as assess the overall effectiveness of our remittance processing program. The new Deposit Error Measure was implemented in concert with establishment of national and local SPC deposit accuracy goals; design of statistically valid SPC Program Analysis System (PAS) quality review plans; development of a new Deposit Accuracy User Guide; and creation of a new national Submission Processing Measures Analysis and Reporting Tool (SMART).

Our baseline year was FY 2001, and we used it to fine tune and improve error capture information. In FY 2002, developing the SMART database was our primary focus, in addition to the continual improvement efforts. On June 17, 2002, we began conducting program reviews of the Deposit Error Measure at the processing campuses. As of September 2002, we completed three program reviews. The reviews included, but were not limited to, sample selection, case file documentation, managerial reviews, and error coding.

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Attached are our comments to your recommendations.

If you have any questions, please call me or Ronald S. Rhodes, Director, Customer Account Services, at (404) 338-8910.

Attachment

The Internal Revenue Service Needs to Improve Oversight of Remittance Processing Operations

Attachment

RECOMMENDATION 1

The Director, W&I Division, Customer Account Services, should ensure that the sampling plan is being implemented consistently at the SPCs. Field visitations and increased oversight by the National Headquarters Deposit Error Balanced Measure staff could provide additional guidance and direction to the individual campuses.

ASSESSMENT OF CAUSE:

The Deposit Error Rate Measure is new, and each processing center is still learning how best to implement the program. The Balanced Measure IRM 3.0.275 provides sampling procedures; however, some sites were deviating from those procedures.

CORRECTIVE ACTION:

The Director, Submission Processing (SP) sent an e-mail to all SP Directors asking them to ensure the appropriate sampling techniques are followed and to review monthly a sample of all measured cases. Conferences have been held with the sites and visits to campuses began June 17, 2002.

IMPLEMENTATION DATE:

Completed August 28, 2002

RESPONSIBLE OFFICIALS:

Chief, Program Management/Process Assurance Branch
Director, Submission Processing
Commissioner, Wage and Investment Division

MONETARY BENEFITS:

N/A

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 2

Program Analysis System (PAS) first-line managers should provide increased oversight to ensure that all processing errors are identified during the Deposit Error Measure sample review. Specifically, PAS managers at SPCs should include all cases in their review to ensure that all errors are identified and reported.

ASSESSMENT OF CAUSE:

PAS first-line managers were only reviewing sample cases with errors. Error-free samples were not selected for review.

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CORRECTIVE ACTION:

We told PAS managers during the Balanced Measures conference that they must adhere to the procedures in the Balanced Measure IRM 3.0.275.1.3.2(2). These procedures require them to review monthly a sample of all work assigned to PAS analysts.

IMPLEMENTATION DATE:

Completed September 12, 2002

RESPONSIBLE OFFICIALS:

Chief, Program Management/Process Assurance Branch
Director, Submission Processing
Commissioner, Wage and Investment Division

MONETARY BENEFITS:

N/A

CORRECTIVE ACTION MONITORING PLAN:

N/A